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BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

BOB STUMP, CHAIRMAN

GARY PIERCE

BRENDA BURNS

BOB BURNS

SUSAN BITTER SMITH

ORIGINAL

IN THE MATTER OF THE REORGANIZATION) DOCKET NO. E-04230A-14-0011
 OF UNS ENERGY CORPORATION) DOCKET NO. E-01933A-14-0011


) NOTICE OF FILING

UNS Energy Corporation¹ and Fortis Inc.² hereby file the Direct Testimony of David G. Hutchens and Barry V. Perry in Support of the Settlement Agreement dated May 16, 2014.

RESPECTFULLY SUBMITTED this 2d day of June, 2014

UNS ENERGY CORPORATION AND FORTIS INC.

By

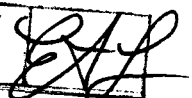

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and

Arizona Corporation Commission
DOCKETED

JUN 02 2014

DOCKETED BY



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REC-111
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BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

**BOB STUMP, CHAIRMAN
GARY PIERCE
BRENDA BURNS
BOB BURNS
SUSAN BITTER SMITH**

IN THE MATTER OF THE)	DOCKET NO. E-04230A-14-0011
REORGANIZATION OF UNS ENERGY)	DOCKET NO. E-01933A-14-0011
CORPORATION)	
)	

Direct Testimony of

David G. Hutchens

In Support of Settlement Agreement

on Behalf of

UNS Energy Corporation and its Affiliates

June 2, 2014

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Exhibits

DGH-3 Settlement Agreement Ratepayer Credits

1 **I. INTRODUCTION.**

2
3 **Q. Please state your name and business address.**

4 A. My name is David G. Hutchens. My business address is 88 East Broadway Blvd.,
5 Tucson, Arizona 85701.
6

7 **Q. Have you previously submitted Direct Testimony in this proceeding?**

8 A. Yes. I submitted Direct Testimony on January 24, 2014 in support of the Joint Notice of
9 Intent to Reorganize ("Joint Notice") that was filed on January 10, 2014 in Docket Nos.
10 E-04230A-14-0011 and E-01933A-14-0011 ("Docket").
11

12 **Q. Have there been management changes at UNS Energy Corporation ("UNS Energy")**
13 **since the Direct Testimony was filed on January 24, 2014?**

14 A. Yes. Paul Bonavia (who also submitted testimony on January 24, 2014) has stepped
15 down as Chief Executive Officer of UNS Energy. He now serves as Executive Board
16 Chair of UNS Energy. I am now Chief Executive Officer and President of UNS Energy,
17 Tucson Electric Power Company ("TEP"), UniSource Energy Services, Inc. ("UES"),
18 UNS Electric, Inc. ("UNS Electric"), and UNS Gas, Inc. ("UNS Gas") (TEP, UNS
19 Electric and UNS Gas will be referred to collectively as the "Regulated Utilities").
20

21 **Q. Have there been any other developments since the filing of the Joint Notice?**

22 A. Yes. Approvals for the merger transaction have been obtained from UNS Energy
23 shareholders, the Federal Energy Regulatory Commission, and the Committee on Foreign
24 Investment in the United States.
25
26
27

1 **Q. What is the purpose of your Testimony?**

2 A. The purpose of my Testimony is to support the May 16, 2014 Settlement Agreement
3 (“Settlement Agreement”) that was filed with the Arizona Corporation Commission
4 (“Commission”) in this Docket. In this Testimony, I will: (i) provide background on the
5 proposed transaction and an overview of the Settlement Agreement, (ii) discuss the
6 settlement process and UNS Energy’s support for the Settlement Agreement, and (iii)
7 provide an overview of the Settlement Agreement’s key provisions.

8
9 I will further explain how the order issued in this Docket will replace the conditions that
10 the Commission adopted in Decision No. 60480 (November 25, 1997), which is the order
11 that created TEP’s holding company, UniSource Energy Corporation (now UNS Energy)
12 (“1997 TEP Holding Company Order”).

13
14 Finally, I discuss why UNS Energy and the Regulated Utilities believe the Settlement
15 Agreement should be approved under the three standards set forth in Arizona
16 Administrative Code R14-2-803(C) and why approval of the acquisition, subject to the 66
17 conditions in the Settlement Agreement, is in the public interest.

18
19 **II. BACKGROUND AND SUMMARY.**

20
21 **A. Overview of the Fortis/UNS Energy Transaction.**

22
23 **Q. Please describe the proposed transaction between Fortis and UNS Energy.**

24 A. The proposed transaction was described in detail in the Direct Testimony filed by the
25 Joint Applicants. I will provide an overview to put the Settlement Agreement in context.
26 Upon completion of the acquisition, UNS Energy will cease being a publicly traded
27 company, with Fortis becoming the ultimate parent company of UNS Energy, UES, and

1 the Regulated Utilities. Fortis is, and will remain, a publicly traded company.

2
3 Fortis is well-qualified to be the ultimate parent of the Regulated Utilities. It has a long
4 track record in the ownership of well-run regulated electric and gas utilities. The
5 cornerstone of its operating philosophy is that its utility subsidiaries should be managed
6 at the local level on a standalone basis. Consistent with Fortis' philosophy, the
7 acquisition will allow UNS Energy to build upon and preserve the local character and
8 strengths of the Regulated Utilities while providing them with improved access to debt
9 and equity capital based on the financial strength of Fortis.

10
11 Through its wholly-owned subsidiaries, Fortis is the largest investor-owned electric and
12 gas distribution utility in Canada. It provides gas and electric service to approximately
13 2.5 million customers through utility subsidiaries in Canada, New York State and the
14 Caribbean. Fortis has total assets exceeding C\$18.6 billion¹, and a market capitalization
15 of C\$7.0 billion compared with UNS Energy's total assets of US\$4.5 billion and a market
16 capitalization of approximately US\$2 billion before the announcement of the proposed
17 acquisition.

18
19 Additional information about Fortis, its operating philosophy and its financial strength is
20 included in the Direct Testimonies of H. Stanley Marshall and Barry V. Perry.

21
22 **Q. Why is the financial strength of Fortis important to the Regulated Utilities and their**
23 **customers?**

24 **A.** As explained in greater detail in the Joint Applicants' Direct Testimonies, the acquisition
25 will improve UNS Energy's access to debt and equity capital. For the Regulated Utilities
26 and their customers, access to capital is especially important because the companies

27

¹ C\$ signifies Canadian dollars.

1 anticipate making \$2 billion in capital expenditures over the next five years in order to
2 maintain safe, reliable service to our customers. Approximately half of these capital
3 expenditures will be made over the next two years, including the following significant
4 investments in generation:

- 5 • TEP's and UNS Electric's \$219 million purchase of Gila River Unit 3,
6 anticipated to close in December 2014;
- 7 • TEP's \$65 million purchase of a 35% interest in Unit 1 of the Springerville
8 Generating Station ("SGS"), anticipated to close in December 2014 and
9 January 2015; and
- 10 • TEP's \$73 million purchase of SGS fuel handling facilities, anticipated to
11 close in April 2015.

12
13 **Q. How will the acquisition affect the quality of service to your customers?**

14 A. Our customers will continue to receive safe and reliable service from the Regulated
15 Utilities. The Settlement Agreement includes specific conditions to protect quality of
16 service. Moreover, our improved access to capital resulting from this transaction will
17 help us make the investments needed to continue to provide safe, reliable and cost-
18 effective service to our customers.

19
20 **Q. How will the acquisition impact rates charged to customers?**

21 A. Aside from the bill credits that will be given to the Regulated Utilities' customers as
22 discussed later in my testimony, the rates approved in the most recent rate orders for each
23 of the Regulated Utilities will remain in effect until such time as the Commission
24 approves new rates. Regarding future rate cases, the Regulated Utilities will likely have a
25 lower cost of debt than they would without the transaction due to the expected credit
26
27

1 ratings upgrades.² As a result of future improved credit ratings, future rates for the
2 Regulated Utilities are expected to be lower with approval of the acquisition than they
3 would be otherwise, thus providing a substantial benefit to customers' rates.
4

5 **B. Summary of the Settlement Agreement.**
6

7 **Q. Please summarize the terms and provisions included in the Settlement Agreement.**

8 A. The Settlement Agreement is very straightforward. First, Signatories to the Settlement
9 Agreement agree that, subject to the conditions contained therein, approval of the
10 acquisition serves the public interest and does not impair UNS Energy or the Regulated
11 Utilities in any way. The Settlement Agreement includes 66 conditions ("Settlement
12 Conditions") that include and expand upon the conditions proposed by the Joint
13 Applicants in the Joint Notice. The Settlement Conditions provide substantial benefits
14 and protections for customers of the Regulated Utilities, including:

- 15 • customer credits of \$30 million spread over 5 years, including \$10 million of
16 credits in the first year;
- 17 • an immediate equity infusion of \$220 million into the Regulated Utilities;
- 18 • protections against any adverse rate impact from the costs of the acquisition;
- 19 • credit quality and capital structure provisions;
- 20 • support of existing levels of contributions to charitable and community
21 programs;
- 22 • maintenance of existing low-income customer assistance programs;
- 23 • maintenance of existing employment and employee benefit levels for a period
24 of at least four years after the conclusion of the acquisition;
- 25 • maintenance of the existing local management of UNS Energy and the

26
27 ² As discussed in the Direct Testimony of Kevin Larson filed on January 24,, 2014, S&P and Fitch Ratings Inc. indicated that TEP's ratings could be raised by one notch if the acquisition is approved, while Moody's acknowledged the benefit of joining an established utility company of Fortis' size and scope.

1 Regulated Utilities and their control over operations;

- 2 • maintenance of the headquarters of UNS Energy and the Regulated Utilities in
3 Tucson;
- 4 • requirements that the new UNS Energy Board of Directors have a majority of
5 the board members be independent and that a majority will reside in Arizona;
- 6 • financial transparency and reporting requirements; and
- 7 • corporate governance requirements to protect the Regulated Utilities from any
8 potential adverse impacts of the acquisition.

9 The Settlement Conditions are discussed later in more detail.

10

11 Second, the Settlement Conditions incorporate applicable conditions from the 1997 TEP
12 Holding Company Order, with the intent that the conditions approved in this Docket will
13 replace the conditions in the 1997 TEP Holding Company Order.

14

15 Third, the signatories to the Settlement Agreement request that the Commission approve
16 the Settlement Agreement no later than September 18, 2014 so that the transaction can
17 close by September 30, 2014. This timing has the benefit of: (i) allowing the Purchased
18 Power and Fuel Adjustment Clause ("PPFAC") credit to go into effect on October 1,
19 2014 to partially offset the October 1, 2014 TEP PPFAC increase³; (ii) allowing the UNS
20 Gas Purchased Gas Adjustor ("PGA") credit to go into effect on October 1, 2014 as bills
21 begin to increase during the winter heating season; and (iii) reducing debt financing costs
22 and related costs needed for the purchase of Gila River Unit 3 and SGS assets.

23

24

25

26

27

³ Decision No. 74439 (April 18, 2014).

1 **III. SETTLEMENT PROCESS.**

2
3 **Q. Please provide an overview of the settlement process.**

4 A. Pursuant to the procedural orders issued in this Docket, formal settlement discussions
5 were noticed and began on May 5, 2014, after Direct Testimony was filed by the
6 Commission's Utility Division Staff ("Staff") and other intervening parties.

7
8 All parties to the Docket were notified of the meetings and invited to participate either in
9 person or telephonically.

10
11 Thereafter, the final details of the Settlement Agreement, including the numerous
12 conditions, were negotiated and incorporated into a definitive draft. All parties were
13 given the opportunity to review and comment on the Settlement Agreement before it was
14 finalized. They were also given the opportunity to become Signatories to the Settlement
15 Agreement before it was filed on May 16, 2014.

16
17 **Q. Do you believe that the settlement process was open and transparent?**

18 A. Yes, I do. All parties to the Docket were invited to participate and most of the parties
19 attended the settlement discussions in person. As a result of the process, Staff, RUCO
20 and eight other intervenors representing diverse interests became Signatories to the
21 Settlement Agreement. I would like to take this opportunity to thank all of the parties for
22 their participation in a very cooperative and constructive settlement process.

23
24 **IV. SETTLEMENT PROVISIONS.**

25
26 **Q. What are the three primary elements of the Settlement Agreement?**

27 A. The Settlement Agreement sets forth 66 conditions of approval. It also addresses how the

1 approval of the proposed acquisition will impact the 1997 TEP Holding Company Order.
2 Finally, the Settlement Agreement requests Commission approval of the Settlement
3 Agreement by September 18, 2014.

4
5 **A. Settlement Conditions.**

6
7 **Q. Please provide an overview of the conditions of approval set forth in the Settlement**
8 **Agreement from UNS Energy's perspective.⁴**

9 A. The 66 Settlement Conditions represent a combination of the conditions proposed by
10 Staff, RUCO and other intervenors in their Direct Testimonies as well as 24 conditions
11 that the Joint Applicants proposed in the Joint Notice (to the extent they were not
12 addressed by conditions proffered by other parties). Moreover, the Settlement Conditions
13 include conditions from the 1997 TEP Holding Company Order.

14
15 Attachment A to the Settlement Agreement sets forth the Settlement Conditions.
16 Generally, the Settlement Conditions address: customer benefits and protections; credit
17 quality and capital requirements; quality of service; customer programs; corporate
18 governance; financial transparency and reporting requirements; acknowledgment of
19 Arizona laws and procedures; and other miscellaneous issues.

20
21 **Q. Do you believe that the Settlement Conditions address the concerns raised by Staff,**
22 **RUCO and other intervenors?**

23 A. I believe they address the vast majority of concerns raised in the Direct Testimony. The
24 Settlement Conditions do not attempt to address issues that are generally considered to be
25 policy issues within the Commission's purview, to revisit issues that the Commission has

26
27 ⁴ The Direct Testimony of Barry V. Perry in support of the Settlement Agreement addresses the Settlement Conditions that specifically impact or place specific commitments on Fortis upon, and subsequent to, its acquisition of UNS Energy.

1 addressed in the past, or to address issues that are clearly outside the scope of this
2 Docket.

3
4 As noted in Section 2 of the Settlement Agreement, the Signatories agree that the merger
5 transaction, subject to the 66 Settlement Conditions, is in the public interest and would
6 not impair UNS Energy or the Regulated Utilities.

7
8 **1. Customer Benefits and Protections.**

9 **Q. Please describe the conditions regarding customer benefits and protections.**

10 **A.** Conditions 1 through 15 contain provisions intended to provide customer benefits and
11 protections. The two most notable customer benefit conditions are Condition 1, which
12 provides for \$30 million of customer credits over the next five years, and Condition 2,
13 which requires Fortis to infuse \$220 million of equity into the Regulated Utilities through
14 UNS Energy within 60 days of the close of the transaction.

15
16 There are also numerous conditions that are designed to protect the Regulated Utilities'
17 customers from costs related to the merger. For example, transaction costs, acquisition
18 premiums or other costs related to the merger will not be recovered through rates.

19
20 **Q. How will the \$30 million in bill credits be passed on to the customers?**

21 **A.** A total of \$10 million will be credited to the Regulated Utilities' customer bills in Year
22 One (starting on October 1, 2014) and a total of \$5 million will be credited each year in
23 Years Two through Five. The allocation of the total credit amount among the Regulated
24 Utilities will be based on number of customers. For example, in Year One, of the \$10
25 million total, approximately \$6.3 million would go to TEP customers, \$1.4 million would
26 go to UNS Electric customers and \$2.3 million would go to UNS Gas customers.

1 For Year One, the credits will be made through both a bill credit to the monthly customer
2 charge (\$5 million) and PPFAC and PGA credits (\$5 million). The monthly bill credit
3 will be calculated as an amount proportional to the average monthly customer charge in
4 each class. The PPFAC/PGA credit will offset the PPFAC/PGA rate.

5
6 For Years Two through Five, the \$5 million in annual credits will be applied to the
7 monthly customer charge. There will not be a PPFAC or PGA credit applied in years
8 Two through Five.

9
10 Finally, as provided in Condition 1(c), the bill credit will be applied only for a six month
11 period from October 1 through March 31 for each of the next five years.

12
13 As a result of Condition 1, in the first six months of Year One, the combined monthly
14 charge credit and the PPFAC/PGA credit will result in a winter bill reduction for the
15 average residential customer of approximately 2% for TEP, approximately 2.5% for UNS
16 Electric and approximately 4% for UNS Gas.

17
18 The attached Exhibit DGH-3 provides (i) additional information on the allocation of the
19 \$30 million among the Regulated Utilities, and (ii) the estimated bill impact of the credits
20 for the average residential customers of each Regulated Utility.

21
22 **Q. How will the \$220 million equity infusion benefit the Regulated Utilities and their**
23 **customers?**

24 **A.** TEP and UNS Electric plan to make significant capital expenditures towards the end of
25 this year, including the acquisition of Gila River Unit 3. The equity infusion will reduce
26 the need for debt financing of those purchases, thereby reducing interest costs that will be
27 passed on to customers through the ratemaking process. On a long-term basis, this

1 additional equity improves the financial strength of the Regulated Utilities.

2
3 **2. Credit Quality and Capital Requirements.**

4 **Q. Please describe the conditions regarding credit quality and capital requirements.**

5 A. Conditions 16 through 25 address credit quality and capital requirements following the
6 merger. Most notable is Condition 16, which will improve the capital structure of the
7 Regulated Utilities through restrictions on dividends for the earlier of five years or until
8 such time as the respective Regulated Utility's equity capitalization reaches 50 percent.

9
10 Additionally, Conditions 17, 21 and 24 require UNS Energy to maintain a capital
11 structure separate from Fortis, to maintain separate banking, credit facility and cash
12 management arrangements and to continue to maintain separate credit ratings from Fortis.
13 Moreover, other conditions restrict the ability of the Regulated Utilities from providing
14 certain financial support to Fortis, including Condition 25, which prohibits cross-default
15 provisions that could impact the Regulated Utilities.

16
17 **3. Quality of Service.**

18 **Q. Please describe the conditions regarding quality of service.**

19 A. Conditions 26 through 30 provide requirements that are intended to ensure the Regulated
20 Utilities' customers continue to receive at least the level of safe, reliable utility service
21 that customers are currently receiving. For example, Condition 26 requires that senior
22 management will be "on the ground" in Arizona to address customer service issues.
23 Condition 27 provides that employee levels will be maintained for a period of at least
24 four years – supporting the Regulated Utilities' efforts to maintain or improve customer
25 service and service quality levels. Moreover, under Condition 29, the Regulated Utilities
26 commit to continue their ongoing efforts to maintain and improve safe and reliable
27 service.

1 4. **Customer Programs.**

2 **Q. Please describe the conditions regarding customer programs.**

3 A. Conditions 31 through 35 primarily address issues raised in the intervenors' testimonies
4 and reflect the Joint Applicants' willingness to continue to work constructively with a
5 variety of stakeholders. Under these conditions, the Regulated Utilities have committed
6 to continue certain customer programs. For example, Condition 35 provides that the
7 Regulated Utilities and Fortis commit to continue low-income assistance programs at or
8 above current levels.

9
10 5. **Corporate Governance.**

11 **Q. Please describe the conditions regarding corporate governance?**

12 A. Conditions 36 through 42 reflect provisions intended to protect the Regulated Utilities
13 and their customers from financial weakness that may be suffered by Fortis in the future.
14 These "ring fencing" conditions require that a majority of the members of the UNS
15 Energy board of directors be Arizona residents and that a majority be independent.
16 Additionally, a "golden share" mechanism will be established. These conditions ensure
17 that Arizona interests continue to be represented in the corporate governance process.

18
19 These conditions also require that the corporate headquarters remain in Tucson and
20 provide that local management continue to make decisions about the Regulated Utilities'
21 operations.

22
23 6. **Financial Transparency and Reporting Requirements.**

24 **Q. Please describe the conditions regarding financial transparency reporting**
25 **requirements?**

26 A. Conditions 43 through 51 provide a means by which the Commission has necessary
27 access and information to oversee the reorganized corporate entities. For example,

1 Condition 43 sets forth an annual reporting requirement that tracks compliance with the
2 Settlement Conditions. Condition 46 requires UNS Energy to keep accounting books and
3 records separate from Fortis and to continue to make those records available to the
4 Commission. Condition 47 requires Fortis to provide access to its records regarding any
5 transaction that may have some direct or indirect impact on the Regulated Utilities.

6
7 **7. Other Conditions.**

8 **Q. Please describe the conditions regarding other issues.**

9 A. Conditions 52 through 66 address a variety of topics. These conditions describe various
10 Arizona laws and procedures applicable to Fortis, UNS Energy and the Regulated
11 Utilities. For example, under Condition 54, UNS Energy and the Regulated Utilities will
12 not share customer-specific information with Fortis affiliates except under certain
13 circumstances and parameters.

14
15 These conditions also contain several conditions from the 1997 TEP Holding Company
16 Order and other conditions related to relations between affiliated companies. For
17 example, Condition 58 requires that the Regulated Utilities develop and submit for
18 Commission approval proposed procedures for valuing and allocating intercompany
19 transactions to and between the Regulated Utilities and other affiliates, including the
20 transfers of goods and services among them.

21
22 **B. 1997 TEP Holding Company Order.**

23
24 **Q. Why does the Settlement Agreement address the existing 1997 TEP Holding**
25 **Company Order?**

26 A. The 1997 TEP Holding Company Order approved the creation of UniSource Energy
27 Corporation (since renamed UNS Energy) as a holding company for TEP. It contains a

1 variety of conditions that were relevant 17 years ago given the circumstances that existed
2 at the time. Since then, significant changes at UNS Energy and the evolving utility
3 landscape have rendered certain conditions meaningless, ineffective or inappropriate.
4 The Commission has modified some of those conditions in the past to reflect such
5 changes. See Decision No. 71256 (September 3, 2009); Decision No. 62103 (November
6 30, 1999). There have been additional changes to circumstances since 2009, and the
7 acquisition will further affect the appropriateness and applicability of those old
8 conditions.

9
10 In light of these changing circumstances and modifications, it is difficult to know which
11 conditions of the 1997 TEP Holding Company Order are in effect and which are not.
12 Once the proposed Fortis-UNS Energy merger is approved, the Commission is effectively
13 creating a new holding company. Going forward, it would be even more challenging to
14 interpret the 1997 TEP Holding Company Order in conjunction with the order in this
15 Docket. Therefore, it makes sense to update the still-relevant conditions from the 1997
16 TEP Holding Company Order and incorporate them in the order in this Docket and then
17 vacate the conditions of the 1997 TEP Holding Company Order. As a result of this
18 approach, all conditions related to this new holding company structure will be located in
19 one order.

20
21 **Q. Does the Settlement Agreement include appropriate “hold over” conditions from the**
22 **1997 TEP Holding Company Order?**

23 **A.** Yes. As part of the settlement process, the Signatories carefully reviewed the 1997 TEP
24 Holding Company Order conditions and agreed upon which conditions should continue
25 in force. Those conditions are included in the 66 Settlement Conditions. Section 3 of the
26 Settlement Agreement further provides that the conditions adopted in this Docket shall
27 supersede the conditions of the 1997 TEP Holding Company Order and that such

1 superseded conditions be vacated.

2
3 **C. Timing of the Approval of the Acquisition.**

4
5 **Q. The Settlement Agreement includes a provision concerning approval by September**
6 **18, 2014. Could you explain why that provision is important?**

7 **A.** In Section 1.9 of the Settlement Agreement, the Signatories request that the Commission
8 approve the Settlement Agreement no later than September 18, 2014. This will allow the
9 transaction to close by September 30, 2014. Closing the transaction by September 30 has
10 several benefits. First, the PPFAC credit provided by Condition 1 can go into effect on
11 October 1, 2014 to partially offset the October 1, 2014 TEP PPFAC increase⁵. Similarly
12 the PGA credit for UNS Gas customers can go into effect as bills begin to rise during the
13 winter home heating season.

14
15 Second, as a result of the acquisition, Fortis will immediately infuse \$220 million of
16 equity into the Regulated Utilities through UNS Energy. This equity infusion will reduce
17 the amount and cost of debt financing required for the purchase of Gila River Unit 3 and
18 the SGS assets later this year and early next year. Again, this, coupled with the
19 anticipated credit rating upgrade, will result in lower interest costs and an improved
20 financial profile for the Regulated Utilities.

21
22 **V. RULE 803(C) FACTORS AND THE PUBLIC INTEREST.**

23
24 **Q. Do you believe the acquisition, subject to the Settlement Conditions, should be**
25 **approved by the Commission under the standard set forth in Arizona**
26 **Administrative Code R14-2-803(C)?**

27

⁵ Decision No. 74439.

1 A. Yes, I do. A.A.C. R14-2-803(C) states that "At the conclusion of any hearing on the
2 organization or reorganization of a utility holding company, the Commission may reject
3 the proposal if it determines that it would impair the financial status of the public utility,
4 otherwise prevent it from attracting capital at fair and reasonable terms, or impair the
5 ability of the public utility to provide safe, reasonable and adequate service." The
6 acquisition will not impair the financial status of any of the Regulated Utilities, nor will it
7 prevent them from attracting capital at fair and reasonable terms. To the contrary,
8 affiliation with the financial strength of Fortis should **improve** the financial status of the
9 Regulated Utilities and their access to debt and equity capital on more favorable terms.

10
11 The acquisition also will not impair the ability of any of the Regulated Utilities to provide
12 safe, reasonable and adequate service. The Regulated Utilities will continue to provide
13 safe, reliable service to customers under their existing local management team in
14 accordance with the standalone operating philosophy of Fortis while also having access
15 to the best practices of Fortis' well-run utilities. The increased access to the capital
16 markets will help the Regulated Utilities make the investments needed to maintain a high
17 quality of service to their customers. Moreover, Fortis, UNS Energy and the Regulated
18 Utilities have committed to continuing their steady efforts to maintain and improve the
19 current quality of utility service.

20
21 **Q. Do you believe that Commission approval of the acquisition subject to the**
22 **Settlement Conditions is in the public interest?**

23 A. Yes. The financial benefits of the acquisition, coupled with the extensive commitments
24 embodied in the Settlement Conditions, will provide tangible benefits to the customers of
25 the Regulated Utilities and communities they serve. Moreover, Fortis has a solid track
26 record with the ownership of well-run, locally managed utilities

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VI. CONCLUSION.

Q. Do you have any concluding remarks?

A. Yes. The acquisition is beneficial to the Regulated Utilities, their customers and the communities they serve. I believe that Commission approval of this acquisition is in the public interest.

Q. Does this conclude your testimony?

A. Yes.

Exhibit DGH - 3

Exhibit DGH-3

Settlement Agreement Ratepayer Credits \$10 million in Year 1; \$5 million per year in Years 2-5

Allocation of \$30 million among Regulated Utilities

Allocation of \$10 million for Year 1

<u>Utility</u>	<u>Customers</u>	<u>Percentage</u>	<u>Allocation</u>
TEP	409,528	62.90%	\$6,290,000
UNSE	92,550	14.22%	\$1,422,000
UNSG	148,955	22.88%	\$2,288,000

Allocation of \$5 million for Years 2-5

<u>Utility</u>	<u>Customers</u>	<u>Percentage</u>	<u>Allocation</u>
TEP	409,528	62.90%	\$3,145,000
UNSE	92,550	14.22%	\$711,000
UNSG	148,955	22.88%	\$1,144,000

Average Residential Bill Impact¹

Year 1	TEP	UNSE	UNSG
Monthly Charge Credit	\$1.07	\$1.15	\$1.19
PPFAC/PGA Credit ²	<u>\$0.56</u>	<u>\$0.69</u>	<u>\$1.66</u>
Total Credit	\$1.63	\$1.84	\$2.85
 Years 2-5	 TEP	 UNSE	 UNSG
Monthly Charge Credit	\$1.07	\$1.15	\$1.19

¹ Credits will only be applied during six-month period (October 1 through March 31) for each year.

² PPFAC/PGA credits based on average monthly usage October 1-March 31: TEP & UNSE - 700 kWh; UNSG - 64 therms.

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BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

**BOB STUMP- CHAIRMAN
GARY PIERCE
BRENDA BURNS
BOB BURNS
SUSAN BITTER SMITH**

**IN THE MATTER OF THE REORGANIZATION)
OF UNS ENERGY CORPORATION)**

**DOCKET NO. E-04230A-14-0011
E-01933A-14-0011**

Direct Testimony of

BARRY V. PERRY

In Support of the Settlement Agreement

on Behalf of

Fortis Inc. and its Affiliates

June 2, 2014

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1 **I. INTRODUCTION**

2
3 **Q. Please state your name and business address.**

4 A. My name is Barry V. Perry. I am the Vice President, Finance and Chief Financial
5 Officer ("CFO") of Fortis Inc. ("Fortis"). My office address is The Fortis Building, Suite 1201,
6 139 Water Street, St. John's, Newfoundland and Labrador, Canada.
7

8 **Q. Are there any planned management changes at Fortis that will impact your role**
9 **within the organization?**

10 A. Yes. On May 12, 2014, the President and Chief Executive Officer ("CEO") of Fortis,
11 Mr. H. Stanley Marshall, announced his retirement effective December 31, 2014. On that same
12 date, the Board of Directors of Fortis announced that I would succeed Mr. Marshall as President
13 of Fortis effective June 30, 2014 and as CEO effective December 31, 2014.
14

15 **Q. Have you previously submitted Direct Testimony in the proceeding?**

16 A. Yes. On January 24, 2014, I submitted Direct Testimony on behalf of Fortis and its
17 Affiliates in conjunction with the Joint Notice of Intent to Reorganize¹ (the "Joint Notice") filed
18 on January 10, 2014 in Docket Nos. E-04230A-14-0011 and E-01933A-14-0011 ("Docket").
19

20 **Q. What is the purpose of your Testimony at this time?**

21 A. I will first summarize the business model, operating philosophy and financial condition
22 of Fortis, including how the regulated utility subsidiaries of Fortis are managed, operated and
23 financed on a standalone basis. I will also describe how the operating philosophy of Fortis,
24

25 ¹ The Joint Notice of Intent to Reorganize pertains to the merger of Color Acquisition Sub Inc. ("Color
26 Acquisition"), a wholly-owned subsidiary of FortisUS Inc. ("FortisUS"), with UNS Energy. FortisUS is a wholly-
27 owned subsidiary of FortisUS Holdings Nova Scotia Limited ("FortisUS Nova Scotia"), which is a wholly-owned
28 subsidiary of Fortis. UNS Energy is the parent company of UniSource Energy Services, Inc. ("UES"), Tucson
Electric Power Company ("TEP"), UNS Electric, Inc. ("UNS Electric") and UNS Gas, Inc. ("UNS Gas") (TEP,
UNS Electric and UNS Gas are referred to collectively as the "Regulated Utilities").

1 including its commitment to locally run utilities, is focused on employees, communities and
2 customers. I will then explain how the Fortis philosophy will be applied to UNS Energy after
3 the transaction closes and how that philosophy will enhance and improve UNS Energy's and the
4 Regulated Utilities' ability to access capital on more favorable terms.

5 I will conclude my testimony with a discussion of the conditions Fortis agreed to in the
6 Settlement Agreement dated May 16, 2014, which provide financial protection, regulatory
7 transparency and community and customer commitments. These conditions collectively are
8 consistent with the Fortis philosophy, beneficial to customers of the Regulated Utilities and in
9 the public interest.

10 11 **II. BACKGROUND**

12
13 **Q. Please provide an overview of Fortis and its business model and operating**
14 **philosophy, as outlined in your Direct Testimony of January 24, 2014.**

15 A. Fortis is a utility holding company and is the largest investor-owned distribution utility
16 company in Canada, providing regulated electricity and gas services to approximately 2.5
17 million customers in New York State, five Canadian provinces and two Caribbean countries.
18 The regulated utilities of Fortis account for approximately 90% of its total assets.

19 Fortis is a long-term investor in North American, regulated utilities. The long-term
20 business objective of Fortis is to manage and grow its investment in regulated electric and gas
21 utilities and to provide a framework for the provision of safe, reliable electricity and gas service
22 to customers within the service territories of its regulated utility subsidiaries. The growth
23 strategy of Fortis is principally based upon long-term organic growth in existing regulated utility
24 operations where Fortis currently invests approximately C\$1 billion per year.² To complement
25 this growth, and to diversify the risk of being concentrated in any one jurisdiction, Fortis
26

27 ² C\$ signifies Canadian dollars.
28

1 pursues acquisitions of regulated utilities in the United States and Canada that fit the Fortis
2 operating model.

3 Fortis believes that the effective management of regulated energy distribution systems
4 requires local management and decision making. The regulated utilities of Fortis are governed,
5 managed, operated and financed on a standalone basis. The operating philosophy of Fortis and
6 its regulated utilities is to maintain strong relationships with their regulators and communities,
7 provide a high level of customer service and maintain a strong financial position. The local
8 management and board of directors of each of Fortis' utility subsidiaries are responsible for
9 executing this operating philosophy.

10 Each of the principal regulated utilities of Fortis has its own board of directors. In the
11 case of FortisBC Energy, FortisBC Electric, FortisAlberta, Maritime Electric, Newfoundland
12 Power, Central Hudson Gas & Electric and Caribbean Utilities, the majority of the directors are
13 independent and most reside in the jurisdiction served by the utility.³

14 Each Fortis regulated utility also has its own senior management team that lives in the
15 area served by the utility and stands accountable to that utility's own board of directors.
16 Within the Fortis group, management focus and accountability are reinforced through effective
17 corporate governance. For example, each utility's senior management team is required to report
18 to its board of directors on the key aspects of utility operations such as safety, customer
19 satisfaction, service continuity, environmental compliance, cost management and financial
20 performance. The senior management team also serves as the direct contact and decision
21 making authority in all regulatory matters.

22 Each Fortis regulated utility has the physical, financial and human resources required to
23 discharge its obligation to provide safe, reliable service. There is no shared services company
24 within the Fortis group. Fortis utilities are encouraged to share best operating practices through
25 collaboration with other utilities within the group where practical. In this regard, each of
26

27 ³ The small regulated utilities of Fortis in Ontario and in the Turks and Caicos Islands do not have independent
28 boards.

1 the utility boards of directors typically includes at least one CEO from an affiliated
2 regulated utility, which helps in the sharing of best practices.

3 Fortis is respectful of regulatory oversight and believes that responsiveness to, and
4 cooperation with, regulators is critical to successful utility operations and the overall success of
5 the enterprise. Fortis has met every commitment it has made to a regulatory body in the course
6 of seeking, and subsequent to obtaining, approval to acquire a public utility. It is a key
7 expectation of Fortis that local management deal respectfully and responsively with local
8 regulators. This expectation is a cornerstone of the Fortis standalone operating philosophy.

9 Fortis also believes that public utilities should be key contributors to the economic
10 development and well-being of the communities they serve. In 2013, Fortis companies
11 contributed in total approximately C\$6 million in sponsorships and in-kind donations to local
12 charitable causes. Employee volunteer efforts are also encouraged, supported and recognized.

13
14 **Q. Please describe the financial condition of Fortis.**

15 A. The financial position of Fortis is strong and stable. Fortis is the largest investor-owned
16 electric and gas distribution utility in Canada with total assets of approximately C\$18.6 billion
17 as of March 31, 2014, and fiscal 2013 revenues exceeding C\$4.0 billion. In 2013, Fortis had
18 cash flow from operations of approximately C\$900 million and earnings of C\$420 million.

19 Fortis has consolidated committed credit facilities of approximately C\$2.7 billion, of
20 which C\$2.4 billion was undrawn as of March 31, 2014. The consolidated facilities include a
21 C\$1.0 billion facility at Fortis.

22 Since the beginning of 2013, Fortis has raised approximately \$3.3 billion in the capital
23 markets, which attests to investors' confidence in our business strategy.

24
25 **Q. Are the common shares of Fortis publicly traded?**

26 A. Yes. The common shares of Fortis are traded on the Toronto Stock Exchange under the
27 ticker symbol "FTS" with a current market capitalization of approximately C\$7.0 billion. The
28

1 current enterprise value of Fortis, which includes common and preferred equity and debt, is in
2 excess of C\$16 billion.

3 The common shares of Fortis are widely held with the majority (approximately 60-70%)
4 being held by a diverse group of retail shareholders. No single shareholder owns, controls or
5 directs more than 10% of Fortis' issued and outstanding common shares.

6 As a publicly traded company in Canada, Fortis is subject to financial reporting and
7 continuous disclosure requirements which have been established by the Canadian Securities
8 Administrators ("CSA"), and which are substantially similar to those of the Securities and
9 Exchange Commission in the United States ("SEC"). These similar disclosure requirements
10 effectively ensure that Fortis meets a standard with respect to public reporting and transparency
11 that is consistent with the SEC standard. The SEC and CSA have adopted a Multijurisdictional
12 Disclosure System which permits eligible Canadian and U.S. issuers to raise capital in cross-
13 border public financings, conduct various cross-border M&A transactions and make continuous
14 disclosure filings while complying primarily with their home country securities regulations,
15 including disclosure and procedural rules.

16
17 **Q. How is Fortis rated by credit rating agencies?**

18 A. Fortis has one of the highest credit ratings among utility holding companies in North
19 America. This is evidence of its strong financial standing and stable risk profile. Fortis has an
20 A- credit rating by Standard & Poor's ("S&P") and an A(low) rating by Dominion Bond Rating
21 Service ("DBRS"). The ratings categories and methodologies of S&P, DBRS, Moody's
22 Investor Services ("Moody's") and Fitch Ratings ("Fitch") are substantially similar.

23 As described in my Direct Testimony of January 24, 2014, a substantial portion of the
24 financing required to complete the acquisition of UNS Energy has already been secured. When
25 Fortis announced its proposed acquisition of UNS Energy, we also announced the offering of
26 C\$1.8 billion of convertible debentures as part of our plan to finance the acquisition. These
27 debentures are convertible to common equity of Fortis once all regulatory and governmental
28

1 approvals required to finalize the acquisition have been obtained and all other outstanding
2 conditions under the Merger Agreement have been fulfilled or waived. Given that convertible
3 debentures are treated as debt by S&P, the agency revised its outlook on Fortis on December
4 13, 2013 from "Stable" to "Negative", while at the same time affirming Fortis' A- credit rating.
5 Actions of this nature are not unusual by credit rating agencies when an announced acquisition
6 is subject to the execution of long-term financing plans. The action taken by S&P in this case is
7 similar to their action in 2012 when Fortis announced its plans to acquire CH Energy Group,
8 Inc.⁴ S&P has stated that, "An outlook revision to stable would likely occur when the
9 convertible debentures are converted to equity, lessening the debt burden." This is expected to
10 occur immediately after closing of the merger transaction.

11 On December 11, 2013, following the announced acquisition of UNS Energy by Fortis,
12 DBRS issued a press release placing the ratings of Fortis under review with developing
13 implications. DBRS based its ratings action on uncertainty with respect to how Fortis plans to
14 finance the acquisition. DBRS indicated that it will further review the financing plan once it is
15 finalized and is expected to issue a further ratings update at that time. Once again, this is
16 similar to the action taken by DBRS in 2012 when Fortis announced its plans to acquire CH
17 Energy Group, Inc.⁵

18
19 **Q. How are the regulated utility subsidiaries of Fortis financed?**

20 A. Each Fortis regulated utility is financed on a standalone basis, and has both standalone
21 credit facilities and senior long-term debt instruments. These utility financing arrangements do
22 not permit lending or guarantees to Fortis or other affiliates. Each of FortisBC Energy, FortisBC
23

24 ⁴ When Fortis announced its intension to acquire CH Energy Group, Inc. in February 2012, S&P's outlook on the
25 credit rating of Fortis was placed on "credit watch with negative implications". In May 2012, Once Fortis put its
26 acquisition plan in place, including the issuance of common equity; S&P returned its outlook on Fortis to "Stable".

27 ⁵ When Fortis announced its intension to acquire CH Energy Group, Inc. in February 2012, DBRS placed the credit
28 rating of Fortis "under review with developing implications". In mid-2012, after Fortis had put its acquisition plan
in place, including the issuance of common equity; DBRS affirmed Fortis' A(low) credit rating and removed it
from "under review with developing implications".

1 Electric, FortisAlberta, Central Hudson Gas & Electric and Newfoundland Power maintain
2 standalone, investment grade credit ratings with at least two nationally recognized rating
3 agencies.
4

5 **Q. How are the regulated utility subsidiaries of Fortis rated by credit rating agencies?**

6 A. Exhibit BVP-2 to my Direct Testimony of January 24, 2014 provides the credit
7 ratings of the rated companies within the Fortis group as of that date.⁶ The principal regulated
8 utilities of Fortis all carry a rating that is superior to the credit ratings of UNS Energy, TEP,
9 UNS Electric and UNS Gas.
10

11 **Q. Why does Fortis wish to complete this acquisition of UNS Energy?**

12 A. The acquisition of UNS Energy is consistent with our long-term business strategy of
13 owning well-run North American regulated electric and gas utilities. Fortis believes it is making
14 a sound long-term investment in Arizona and in UNS Energy.
15

16 The Regulated Utilities are well-run, with a strong UNS Energy management team,
17 dedicated employees, and well-maintained plant and equipment. Fortis believes the economy in
18 Arizona, which is similar in size to the economy of the Province of British Columbia, will
19 continue to outperform other U.S. jurisdictions; thereby providing Fortis with opportunities for
20 capital investment in the Regulated Utilities to meet the future needs of their customers.
21 Moreover, UNS Energy's utility operations and regulatory environment are similar to those of
22 the Fortis Canadian and New York utilities.

23 The Regulated Utilities will increase the overall size of Fortis by approximately 30% and
24 provide Fortis with greater geographical diversity in its portfolio of regulated electric and gas
25 utilities.
26

27 _____
28 ⁶ Moody's upgraded its rating of Central Hudson Gas & Electric on January 30, 2014 from A3 to A2.

1 **Q. How will UNS Energy operate under Fortis ownership?**

2 A. Just as it does today, UNS Energy and the Regulated Utilities will continue to focus
3 on providing safe, reliable and cost-effective service to their customers. As part of the
4 Fortis group of regulated utilities, UNS Energy will continue to be operated, managed and
5 governed locally and shall maintain its headquarters in Tucson, Arizona. Fortis expects that
6 UNS Energy's current officers will continue as the officers of UNS Energy after the acquisition;
7 and Fortis will, within one year, appoint a UNS Energy Board of Directors with oversight over
8 UNS Energy and the Regulated Utilities, a majority of whom shall be independent and a
9 majority of whom shall be residents of Arizona.⁷ All decisions with respect to the
10 operations of UNS Energy and the Regulated Utilities will be made by the local
11 management and independent Board of Directors. These decisions will include, but will
12 not be limited to: capital and operating plans; establishment of dividend policy (consistent
13 with the Settlement Agreement); determination of debt and equity requirements; employment
14 levels, union negotiations and relationships, and hiring practices; the design and delivery of
15 low income, energy efficiency and renewable energy programs; and community
16 involvement. Local management will also continue to represent the Regulated Utilities in
17 all future regulatory matters. This expectation is a cornerstone of the Fortis standalone
18 operating philosophy.

19 UNS Energy will also enjoy improved access to capital on more favorable terms as
20 part of the Fortis group. Also, as part of a federation of well-run North American electric
21 and gas utilities, UNS Energy will be able to draw upon expanded technical, operational,
22 financial and regulatory expertise while remaining a strong, locally-based utility. While this
23 is not a synergy driven transaction, any cost savings from realized synergies that result from the
24 acquisition and that are directly attributable to the Regulated Utilities, including but not limited
25

26 ⁷ As part of the transition to a new board of directors, and as referred to in Sections 1.1(c) and 5.14(c) of the
27 Agreement and Plan of Merger, four (4) UNS Energy board members as of the date of closing will remain
28 members of the UNS Energy Board of Directors following the close.

1 to reduced or eliminated public company costs and reduced insurance costs, which are
2 anticipated, will be beneficial to customers in future rate cases.
3

4 **Q. How do the credit rating agencies view the impact of the acquisition on their**
5 **ratings of UNS Energy and the Regulated Utilities?**

6 A. As discussed in Mr. Hutchens' testimony, and as further described in my Direct
7 Testimony of January 24, 2014, following the announced acquisition of UNS Energy by Fortis,
8 each of the three credit rating agencies who rate TEP (S&P, Fitch and Moody's)
9 commented positively on the rating outlook for TEP following the acquisition. Although
10 there is no guarantee that any of the rating agencies will actually upgrade the credit rating of
11 UNS Energy or TEP following the acquisition, the noted rating agencies' comments reflect their
12 view of the strength of Fortis' financial profile. Further, they confirm that the acquisition is
13 expected to improve the financial status of UNS Energy and the Regulated Utilities and
14 improve their access to capital on more favorable terms.
15

16 **III. SETTLEMENT BENEFITS**
17

18 **Q. What was the extent of your involvement in arriving at a Settlement Agreement?**

19 A. Mr. Hutchens describes the settlement process in some detail in his Direct Testimony.
20 As for my involvement, I personally met with Commission Utilities Division Staff ("Staff") and
21 with representatives from the Residential Utility Consumer Office ("RUCO") prior to the
22 submission of my Direct Testimony on January 24, 2014. Before settlement discussions began,
23 I read the testimony filed in this Docket on April 30, 2014 by Staff, RUCO and the various
24 other intervenors to familiarize myself with their issues and the suggested approval conditions
25 put forth by the various parties. I, then, personally represented Fortis at the settlement
26 discussions which took place in Phoenix, Arizona on May 5, 2014.
27
28

1 **Q. What effect does the Settlement Agreement have on the 24 conditions offered in the**
2 **Joint Notice?**

3 A. The approval conditions contained in the Settlement Agreement include, and build upon,
4 the 24 conditions that were contained in the Joint Notice. Several of the original conditions
5 have now been enhanced to provide greater clarity with respect to, or to strengthen, the
6 commitments made by the Joint Applicants. Others, such as: the commitment to provide direct,
7 tangible customer benefits by way of bill credits; the commitment by Fortis to provide an
8 increased equity injection on closing; the commitment to establish a "golden share"; and, the
9 commitment to provide "follow-on merger savings" that are reasonably applicable to the
10 Regulated Utilities and their customers have been added based primarily on the testimony and
11 recommended conditions of Staff and RUCO. The additional conditions provide significant
12 enhancements that overwhelmingly ensure that the merger transaction is in the public interest.

13
14 **Q. Why does Fortis support the Settlement Agreement?**

15 A. The terms of the Settlement Agreement provide a just and reasonable resolution of the
16 issues arising in this Docket and, among other things, establish appropriate conditions to ensure
17 that quality of service by the Regulated Utilities is maintained, that access to capital for UNS
18 Energy and the Regulated Utilities will be improved, and that unnecessary litigation expense
19 and delay can be avoided.

20 The Settlement Agreement balances the interests of the parties involved and the
21 different perspectives brought forward by the various intervenors; preserves the standalone
22 nature of UNS Energy and the Regulated Utilities; meets the requirements for Commission
23 approval of the reorganization of UNS Energy under A.A.C. R14-2-803; and, in addition,
24 provides tangible customer benefits over and above those required by Arizona law.

1 **Q. Is Fortis still committed to its plans with respect to the acquisition and operation of**
2 **UNS Energy and the Regulated Utilities in light of the additional and enhanced conditions**
3 **contained in the Settlement Agreement?**

4 A. Yes. Fortis looks upon this merger transaction with a long-term view, consistent with
5 our long-term business strategy of owning well-run North American regulated electric and gas
6 utilities. UNS Energy and the Regulated Utilities are well-run; operate within a regulatory
7 environment that is similar to those of Fortis' Canadian and New York utilities; and provide
8 Fortis with greater geographical diversification and opportunities for long-term capital
9 investment in a growing Arizona economy.

10 The additional and enhanced conditions contained in the Settlement Agreement provide
11 support for, and are consistent with, the Fortis standalone utility operating philosophy; and
12 reinforce the commitments initially proposed by Fortis and UNS Energy in the Joint Notice.

13 As a new entrant into the Arizona business community, Fortis recognizes that it must
14 prove to the Commission that it is well qualified as an owner of the Regulated Utilities. Fortis
15 stands by its record and its intentions with respect to the ownership and operation of UNS
16 Energy and the Regulated Utilities. Fortis has delivered on every commitment it has made to a
17 regulatory body in the course of seeking, and subsequent to obtaining, approval to acquire a
18 public utility. And, as referred to in my Direct Testimony of January 24, 2014, the Fortis
19 approach to ownership of regulated utilities has been favorably acknowledged by regulators in
20 several of the jurisdictions in which Fortis currently operates.

21
22 **IV. SETTLEMENT CONDITIONS**

23
24 **Q. Please comment on the conditions in the Settlement Agreement that more**
25 **specifically impact Fortis.**

26 A. The 66 conditions contained in the Settlement Agreement ("Settlement Conditions") are
27 categorized as Customer Benefits & Protections, Credit Quality and Capital Requirements,
28

1 Quality of Service, Customer Programs, Corporate Governance, Financial Transparency and
2 Reporting Requirements, Acknowledgement of Arizona Laws & Procedures, and
3 Miscellaneous. Mr. Hutchens' Direct Testimony will address those Settlement Conditions that
4 are pertinent to the local management of UNS Energy and the Regulated Utilities. I will
5 comment on the Settlement Conditions that specifically impact or place specific commitments
6 on Fortis upon, and subsequent to, its acquisition of UNS Energy.
7

8 *Customer Benefits & Protections*

9 Fortis and UNS Energy have agreed to fund \$30 million in tangible customer benefits
10 which, in accordance with the Settlement Agreement, will be provided to customers of the
11 Regulated Utilities by way of bill credits over 5 years, commencing October 1, 2014. The total
12 bill credits of \$30 million ensure that customers receive immediate benefits as a result of the
13 merger transaction. Fortis and UNS Energy intend to fund these tangible customer benefits
14 upon closing of the merger transaction.
15

16 In the Joint Notice, Fortis had committed to an equity infusion of \$200 million into UNS
17 Energy for the benefit of UNS Energy and the Regulated Utilities upon closing of the
18 transaction. Fortis has agreed, in the Settlement Agreement, to increase the equity infusion
19 upon closing to \$220 million. Fortis and UNS Energy have also committed to not seek any
20 recovery of the acquisition premium or goodwill associated with the merger transaction, nor to
21 seek any recovery of acquisition related costs including change of control or retention
22 payments, or shareholder litigation costs, related to the merger.
23

24 *Credit Quality and Capital Requirements*

25 Fortis and UNS Energy have agreed to limit dividends paid by the Regulated Utilities to
26 UNS Energy to 60 percent of annual earnings for a period of 5 years or until such time as the
27 respective Regulated Utility's equity capitalization reaches 50 percent of total capital,
28 whichever is earlier. This agreed upon commitment, together with the equity funding referred

1 to above and other agreed upon credit quality and capital requirement conditions included in the
2 Settlement Agreement, is expected to increase equity in the Regulated Utilities to 50 percent of
3 total capital within an estimated 3 to 5 years; and will, therefore, help strengthen the financial
4 status of the Regulated Utilities, and provide them with the equity required to meet their future
5 capital needs.

6
7 *Quality of Service*

8 In the Joint Notice, Fortis and UNS Energy committed to maintaining the current level
9 of employees of the Regulated Utilities for a period of 2 years subject to changes in the ordinary
10 course of business. This commitment is extended to 4 years in the Settlement Agreement. This
11 commitment recognizes the importance of maintaining a knowledgeable and capable workforce
12 in order to continue the delivery of safe and reliable service to customers of the Regulated
13 Utilities.

14
15 *Corporate Governance and Financial Transparency and Reporting*

16 Commitments made by Fortis in the Joint Notice, and which have been expanded upon
17 in the Settlement Agreement, with respect to corporate governance and financial transparency
18 and reporting are consistent with and reflect the standalone operating philosophy employed by
19 Fortis in its ownership of regulated electric and gas utilities. The Settlement Conditions with
20 respect to ring fencing, the appointment of a majority of local and independent board of
21 directors, the establishment of a "golden share", maintaining UNS Energy's corporate
22 headquarters in Tucson, Arizona, and maintaining UNS Energy's local management and
23 operations with responsibility for all day-to-day operations of the Regulated Utilities provide
24 that customers are protected and financially separated from Fortis and its other utility
25 operations. Local governance, management and operation of the Regulated Utilities also
26 provides that customers continue to be served by a utility that is positioned to understand the
27
28

1 assets, operations, customer service expectations and applicable regulatory framework within
2 the Arizona jurisdiction.

3 Similarly, Settlement Conditions which provide the Commission with regular status
4 reports, access to Fortis books and records, rules governing affiliate transactions and
5 relationships, and access to senior management of Fortis, if required; and which acknowledge
6 the Commission's authority to regulate the Regulated Utilities, help to ensure that regulatory
7 oversight and transparency is maintained following the merger.

8
9 *Acknowledgement of Arizona Laws & Procedures*

10 Fortis acknowledges the Commission's jurisdiction over the Regulated Utilities and will
11 comply with applicable Arizona and federal statutes and Commission rules including, without
12 limitation, the affiliated interest rules as set forth in the Arizona Administrative Code.

13
14 *Committed for the Long-Term*

15 While Fortis is a long-term investor in regulated electric and gas utilities, as
16 demonstrated by the fact that it has never sold a utility subsidiary, Fortis has specifically
17 committed to not sell or transfer ownership of UNS Energy or any of the Regulated Utilities for
18 a period of at least 5 years. Fortis also acknowledges that any such sale or transfer after 5 years
19 would require advance Commission approval.

20
21 **V. OTHER REQUIRED APPROVALS**

22
23 **Q. What is the status of other approvals that are required prior to closing the merger**
24 **transaction?**

25 **A.** Since the merger transaction was announced on December 11, 2013, approval of the
26 transaction has been obtained from UNS Energy shareholders⁸, the Federal Energy Regulatory

27
28 ⁸ See eDocket E-04230A-14-0011 image 0000152050.

1 Commission⁹, and the Committee on Foreign Investment in the United States¹⁰. In addition to
2 approval by the Commission, completion of the merger transaction remains subject to the
3 expiration or termination of the applicable waiting period under the Hart-Scott-Rodino Antitrust
4 Improvements Act of 1976, as amended, ("Hart-Scott-Rodino") and the satisfaction of other
5 customary closing conditions.
6

7 **Q. What is the anticipated timeline with respect to the Hart-Scott-Rodino approval?**

8 A. Fortis and UNS Energy filed the required Hart-Scott-Rodino notification with the Federal
9 Trade Commission and the Department of Justice on May 30, 2014. If the initial 30-day waiting
10 period expires without a challenge or request for additional information, then the Hart-Scott-
11 Rodino approval will become effective by June 30, 2014. If a request for additional information
12 is received, an additional 30-day waiting period will commence once Fortis and UNS Energy
13 substantially comply with the information request.
14

15 **VI. CONCLUSION**
16

17 **Q. In conclusion, will the acquisition of UNS Energy by Fortis and the commitments**
18 **agreed to in the Settlement Agreement benefit customers, employees and the communities**
19 **that UNS Energy serves?**

20 A. Yes.
21
22
23
24
25
26

27 ⁹ See eDocket E-04230A-14-0011 image 0000152246.

28 ¹⁰ See eDocket E-04230A-14-0011 image 0000153507.

1 **Q. Will approval of the Merger Transaction, subject to the conditions of the**
2 **Settlement Agreement, improve the financial status of UNS Energy and the Regulated**
3 **Utilities, improve their access to capital at more reasonable terms, and enhance the ability**
4 **of the Regulated Utilities to continue providing safe, reasonable and adequate service to**
5 **their customers?**

6 A. Yes.

7
8 **Q. Do you have any concluding remarks?**

9 A. Yes. I would first of all like to thank the parties who participated in what has been an
10 open and transparent settlement process. This Settlement Agreement is in the public interest as
11 it balances the interests of UNS Energy, the Regulated Utilities and the communities they serve,
12 their customers and employees, and Fortis. The Settlement Agreement and associated merger
13 transaction provide substantial and material benefits including, but not limited to, immediate
14 and direct tangible customer benefits by way of bill credits over 5 years, the financial
15 strengthening of UNS Energy and the Regulated Utilities, and benefits to employees and the
16 communities served by the Regulated Utilities.

17 Upon closing of this merger transaction, UNS Energy will join the Fortis federation of
18 regulated utilities and become part of a larger, more diverse and financially secure company
19 with a stronger credit rating and improved access to capital, on more favorable terms.
20 Ultimately, this will be beneficial to the Regulated Utilities and their customers. Commission
21 approval of this acquisition, subject to the conditions of the Settlement Agreement, is just,
22 reasonable and in the public interest.

23
24 **Q. Does this conclude your testimony?**

25 A. Yes.